In support of this draconian result, the court quoted Judge Friendly's oft-cited statement that "[e]quality among creditors who have lawfully bargained for different treatment is not equity but its opposite . . ." *Id.* (citing *Chemical Bank New York Trust Co. v. Kheel*, 369 F.2d 845, 848 (2d Cir. 1966) (Friendly, J., concurring)). But the court ignored Judge Friendly's pointed admonition in the same opinion that to defeat substantive consolidation, such creditors must demonstrate that in bargaining for different treatment "they relied on the separate credit" of the entities. *Kheel*, 369 F.2d at 848. By eliminating consideration of whether there was such "reliance on separate credit" by creditors opposing substantive consolidation, and in other respects, the Third Circuit has deviated significantly from decades of precedent, and at the same time has virtually eliminated this important remedy in that circuit.

CONCLUSION

The decision of the court below creates an even deeper split than had already existed among the circuits regarding the circumstances under which the equitable remedy of substantive consolidation in bankruptcy is appropriate, creating a glaring lack of uniformity on an important issue of federal bankruptcy law. The ramifications of the decision extend far beyond depriving the asbestos-related tort claimants in this case of the full relief to which they are entitled, as it will hamstring courts in the circuit from achieving equitable relief in numerous future cases. There is an immediate and pressing need for guidance from this Court on the standards for substantive consolidation, and Respondent the Official Committee of Asbestos Claimants respectfully asks the Court to grant the Petition of the Legal

Representative for Future Claimants for a Writ of Certiorari to ensure uniform and equitable application of this important bankruptcy remedy.

Respectfully submitted,

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Nos. 05-827, 05-941

In The
Supreme Court of the United States

JAMES J. McMONAGLE, THE LEGAL REPRESENTATIVE FOR FUTURE CLAIMANTS,

Petitioner,

v.

CREDIT SUISSE FIRST BOSTON, AS AGENT, *ET AL.*,

Respondents.

OFFICIAL REPRESENTATIVES OF THE BONDHOLDERS AND TRADE CREDITORS OF DEBTORS OWENS CORNING, *ET AL.*,

Petitioners,

v.

CREDIT SUISSE FIRST BOSTON, AS AGENT, *ET AL.*,

Respondents.

On Petitions For Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

REPLY BRIEF BY PETITIONER JAMES J. McMONAGLE

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REPLY BRIEF FOR PETITIONER JAMES J. McMONAGLE

Petitioner James J. McMonagle, legal representative for future claimants, respectfully submits this reply brief in support of his Petition for a Writ of *Certiorari* to the United States Court of Appeals for the Third Circuit.

The brief filed by the respondent, Credit Suisse First Boston as agent for the bank lenders (hereinafter "the Banks"), underscores rather than undercuts the reasons why the Court should grant *certiorari*. The Banks seek to argue that the case below would have been decided the same way under any of the differing Courts of Appeals tests that have been endorsed by the various Circuits, but their labored effort to make that showing ignores the clear holding of the District Court that under the D.C. Circuit test it applied, substantive consolidation was appropriate. The Banks' brief also suggests that there is no "real" conflict among the Circuits because the fact pattern reflected herein does not exactly replicate that of any previous Court of Appeals case. But the right question, of course, is whether there is a genuine conflict between or among the Courts of Appeals as to the governing legal principles, of a sort that would yield differing results on the same facts and that only this Court can resolve. Clearly there is. It is manifest, for instance, that the Third Circuit's reliance on the "deemed" nature of the consolidation sought here conflicts with previous decisions, and the Banks have failed to rebut the other showings of conflicts made in the petition.

I. THERE IS A CLEAR CONFLICT AMONG CIRCUITS

The Banks spend considerable effort attempting to explain why the decision below, despite the Third Circuit's own language, "really" does not conflict with the decisions of other Courts of Appeals. First, they seek to rationalize at length their suggestion that there is no significant difference between the decision below and the Second Circuit's approach. A similar attempt then is made to explain why the standard utilized by the court below is really no different from that of the D.C. Circuit. Then the Banks turn to the Eleventh Circuit, essaying a similar task. Finally, they seek to show *seriatim* that there is no conflict with the Eighth Circuit, the Ninth Circuit, and the Sixth Circuit. This tortuous exegesis brings to mind the adage about protesting too much.

The reason such an effort on the part of the Banks is required, of course, is that the Third Circuit's decision both acknowledges a pre-existing conflict among Circuits and rejects certain approaches taken by other Courts of Appeals in the course of crafting its own set of substantive consolidation principles. *See, e.g.*, App. 2 (referring to "differing rationales by other courts"); *id.* 18 ("The reasons [offered by the] courts for allowing substantive consolidation as a possible remedy span the spectrum"); *id.* 23 ("To us [the D.C. Circuit's approach] fails to capture completely the few times substantive consolidation may be considered. . . . For example, *we disagree* that '[i]f a creditor makes [a showing of reliance on separateness], the court may order consolidation . . . [even] if it determines that the demonstrated benefits of consolidation 'heavily' outweigh the harm'" (emphasis added)).

One clear example of a conflict relates to the Third Circuit's reliance on the "deemed" nature of the consolidation. Using the derogatory term "make-believe" to characterize deemed consolidations, Opp. 1, the Banks echo the Court of Appeals' use in this respect of the term "pretend." The Court of Appeals relied heavily on this view of the consolidation ordered by the District Court in asserting that "perhaps the flaw *most fatal* to [substantive consolidation in this case] is that the consolidation sought was 'deemed' (*i.e.*, a pretend consolidation) . . . ." App. 35 (emphasis added). Leaving aside how, given that language, the Banks can possibly justify their contention that this part of the Third Circuit's opinion somehow was dictum, *see* Opp. 21, the undeniable point in this regard is that numerous courts have ordered and approved deemed consolidation without in any way deprecating such relief. And those courts include the Sixth Circuit, despite the Banks' self-evidently unsuccessful attempt to deny that fact. *See In re Am. Homepatient, Inc.*, 420 F.3d 559, 570 (6th Cir. 2005).[1]

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[1] There are numerous cases where substantive consolidations was effectuated without actual merger, including cases in which (contrary to the Banks' suggestion) the relief ordered was non-consensual. *See, e.g., In re Am. Homepatient, Inc.*, 298 B.R. 152, 164-166 (M.D. Tenn. 2003) (granting substantive consolidation where "[t]he separate corporate structures of the Debtors shall continue," over objections of lenders, and noting that in substantive consolidation "the benefit – protection of the possible realization of any recovery for the majority of unsecured creditors – outweighs the potential harm to any particular creditor" and that there was credible testimony that "substantive consolidation will return the most to all creditors by pooling the assets and liabilities"); *In re Bonham*, 229 F.3d 750 (9th Cir. 2000) (granting substantive consolidation of individual's bankruptcy estate and two non-debtor corporations controlled by that individual over objection of investors; no indication that actual merger was required); *In re New Ctr. Hosp.*, 187

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Even the "bankruptcy professors" *amicus* brief in the court below, which is cited as support more than once by the Banks, decried the fact that the "[c]ourts have yet to settle on any particular method for measuring when such drastic action [by which they mean substantive consolidation] is warranted."[2] Brief of Amici Curiae Professors 11. Indeed, the professors expressed the view that "[i]n terms of specifying when substantive consolidation is appropriate, courts in other circuits . . . have articulated *differing tests mentioning over a dozen factors* that should be considered in making this determination." *Id.* 3 (emphasis added).[3]

B.R. 560 (E.D. Mich. 1995) (substantive consolidation granted over creditor's objection; no indication that actual merger was required); *In re Tureaud*, 45 B.R. 658 (Bankr. D. Okla. 1985) (same).

[2] Despite the Banks' assertion that the professors' brief reflected the views of "all the bankruptcy scholars who participated in the briefing below," Opp. 11, in point of fact petitioner's position in the Third Circuit was supported by the Commercial Law League of America ("CLLA"). The CLLA is the nation's oldest organization of attorneys and other experts in credit and finance, and its membership includes approximately 4,000 individuals actively engaged in the fields of commercial law, bankruptcy, and reorganizations. The CLLA "has testified on numerous occasions before Congress as an expert in bankruptcy and reorganizations." Brief of the Commercial Law League of America as *Amicus Curiae*, 1.

[3] The Banks take the remarkable position that the D.C. Circuit standard in *In re Auto-Train Corp., Inc.*, 810 F.2d 270 (D.C. Cir. 1987), is not "meaningfully different" from the Second Circuit standard in *In re Augie/Restivo Baking Co.*, 860 F.2d 515 (2d Cir. 1998), because the D.C. Circuit "base[d] its articulation of substantive consolidation standards on decisions from the Second Circuit," Opp. 13 – as if it were not to be expected that any court seeking to articulate a legal standard would frame its standard with reference to earlier case law, whether or not it adopted earlier legal approaches in whole or in part. Suffice it to say that no court and no scholarly authorities, much less the court below, ever claimed that there are no meaningful distinctions between the D.C. Circuit and

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In the end, in fact, despite its effort to obscure the legal test adopted by the court below under a welter of facts with limited relevance, the Banks ultimately concede that the Third Circuit's test would limit substantive consolidation to only those cases where it is "necessary to remedy harm caused by fraud, hopeless commingling of assets, or other corporate irregularities." Opp. 24; *see also id.* 2. Whatever may be said as to whether that should in fact be the test for substantive consolidation – and there are substantial reasons why the test should not be so limited – no other Circuit (indeed, no bankruptcy court) has adopted a legal standard whereby a showing of wrongdoing by the debtor or hopeless commingling of assets is the only basis for substantive consolidation, and the Banks do not suggest otherwise.

II. THE DISTRICT COURT'S DECISION SHOWS BOTH THAT THERE IS A CONFLICT AND THAT THIS CASE COULD WELL BE DETERMINED DIFFERENTLY UNDER ANOTHER STANDARD

The undeniable differences between the approaches taken by the various Circuits as to substantive consolidation are minimized in the Banks' brief through an effort to suggest that all Courts of Appeals would come out as the Third Circuit did "on the facts of this case." Opp. 13. Thus,

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Second Circuit standards. To the contrary, the Third Circuit in constructing its "[v]iew of [s]ubstantive consolidation" explicitly declared that it "favor[s] essentially" the *Augie/Restivo* test over that of *Auto-Train*. App. 23. While the Third Circuit departs from *Augie/Restivo* as well, obviously the mere fact that it purports to favor the Second Circuit test negates the assertion that that test is not meaningfully different from the disfavored "*Auto-Train* approach." *Id.*

the Banks say, there is no "real conflict." But the unsurprising fact that the precise fact pattern involved in the Owens-Corning bankruptcy matter does not exactly replicate that of other cases involving substantive consolidation hardly means that there are not significant divergences among the Courts of Appeals. Those divergences in approach – *i.e.*, in defining the principles and the test that governs when substantive consolidation should be awarded – are clear, as the petition herein shows. Pet. 14-21.

The Banks deny in this respect that other substantive consolidation standards – *e.g.*, that of *Auto-Train* – "would lead to a grant of substantive consolidation on the facts of this case." *Id.* To find the answer to this contention, however, one need look no further than the decision below of Senior District Judge John Fullam (among the most experienced bankruptcy experts in the judiciary). Applying the D.C. Circuit/Eleventh Circuit test reflected in *In re Auto-Train Corp., Inc.*, 810 F.2d 270 (D.C. Cir. 1987), and *Eastgroup Properties v. Southern Motel Assoc., Ltd.*, 935 F.2d 245 (11th Cir. 1991), as well as the Third Circuit's previous discussion of substantive consolidation in *Nesbit v. Gears Unlimited, Inc.*, 347 F.3d 72 (3d Cir. 2003),[4] District Judge Fullam determined on the facts of this case that substantive consolidation was warranted.

Applying *Auto-Train* and *Eastgroup*, the trial court found among other things that "there is substantial identity between the entities to be consolidated." App. 49.

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[4] As the decision below acknowledges, prior to this case the Third Circuit – in *Nesbit* – had "adopt[ed] an intentionally open-ended, equitable inquiry . . . to determine when substantively to consolidate two entities." App. 24; *see also id.* 48-49 (District Court's discussion of *Nesbit*).

The Banks do not dispute, and the Third Circuit did not question, the factual basis on which Judge Fullam found substantial identity between the parent debtor OCD and its wholly-owned subsidiaries. App. 50-51.[5]

The same can be said for the other *Auto-Train* factor necessary to establish a rebuttable *prima facie* case for consolidation – *i.e.*, whether consolidation is necessary "to avoid harm or realize benefits." The District Court found, among other things, that the financial affairs of OCD and its wholly-owned subsidiaries would be exceedingly difficult to untangle. Moreover, contrary to what the Banks would have this Court believe, the trial court found "many reasons for challenging the accuracy" of the intercompany transactions among OCD and its subsidiaries, including the failure to pay interest and questionable calculations of royalties. App. 51. The Banks neglect to mention these findings, and the Third Circuit never questioned them.

While this Court may well wish to remand for a determination as to whether substantive consolidation is appropriate here should it reject the Third Circuit's standard, on the record of this case there is little if anything to support the Banks' extravagant assertion that substantive consolidation is inappropriate under *any* test that might be applied to the facts of this case.

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[5] A minor theme in the Opposition is an implicit criticism of the District Court opinion based on its relative brevity. The opinion was clearly adequate to delineate the nature and basis for its conclusions, however, as is demonstrated by the lack of any significant criticism by any party before the Third Circuit, or by the Third Circuit itself, directed to the adequacy of the District Court's opinion.

III. ORDERING SUBSTANTIVE CONSOLIDATION IN THIS CASE WOULD HAVE NO UNTOWARD CONSEQUENCES

Finally, the Third Circuit's opinion and the Banks' position appear in some measure to be bottomed on a notion that the present case reflects a routine, commonplace financing transaction in today's corporate world. *See* App. 28 ("the Banks did the 'deal world' equivalent of 'Lending 101' "). Therefore, the argument goes, if substantive consolidation is available here, it is available anywhere.

While this point essentially goes only to the wisdom of the Third Circuit's test rather than to whether a conflict among Circuits exists, petitioner has three observations, all of which support granting the writ of *certiorari*. First, to the extent that the present case involves a financing transaction that could in some sense be called paradigmatic – and the Banks certainly have not shown that this is so – the case would represent an excellent vehicle for this Court to end the confusion among the lower courts and help fashion a uniform national standard governing substantive consolidation.

Second, the Third Circuit and the Banks assume, but never demonstrate, that lenders in the real world believe upstream guarantees will be effective in bankruptcy.[6] But in fact there is a considerable literature in the corporate transactional world to the effect that upstream guarantees are of dubious value in bankruptcy, although they may serve other non-bankruptcy purposes. Phillip I. Blumberg, *Intragroup (Upstream, Cross-Stream, and Downstream)*

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[6] Upstream guarantees, of the sort present in this case, involve guarantees to a lender by subsidiaries of the borrower.